BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

I.

Reference to Opinion of the Court Below

The opinion of the Circuit Court of Appeals is reported under the style of Davis, et al., v. City of Homestead, Florida, et al., 112 F. (2d) 438 (advance opinions of July 22, 1940).

The case was argued in the Circuit Court of Appeals along with a somewhat similar case, No. 9369, styled as American Nat. Bank v. City of Sanford, Fla., et al., the opinion in which is reported in 112 F. (2d) 435.

The Homestead opinion adopts and applies the Sanford case opinion. Both should be considered as being opinions delivered by the Court below in this case.

II.

Statement of Grounds of Jurisdiction

The Federal Statute, the construction and validity of which is involved, is Sections 81-84, of Chapter IX of the Bankruptcy Act of August 16, 1937, 50 Stat. 654, as supplemented by the Act of June 22, 1938, 52 Stat. 940 (11 U. S. C. A. § 401-404). The appeal below was taken by these Petitioners under 11 U. S. C. A. § 47 (a). The decision is reviewable by this Court under 11 U. S. C. A. § 47 (c). A Writ of Certiorari is applied for, as provided for by Section 240 of the Judicial Code as amended (28 U. S. C. A. § 347). The opinion of the Circuit Court of Appeals was filed June 5, 1940, and petition for rehearing was denied July 8, 1940.

III.

Statement of the Case

The "Statement of the Case" set out at pages 1 to 3 of the foregoing Petition for Certiorari is believed to be adequate for the purposes of this brief, and therefore is not repeated.

IV.

Specification of Errors Intended to be Urged

Errors of the Circuit Court of Appeals intended to be urged, which are made to appear from its opinion in this case, and from its opinion in the companion City of Sanford case, are:

1. Sanctioning consents or votes amounting to majority control, offered by creditors who had irrevocably scaled their debts to the terms involved, through the fiction of treating such creditors as though they had retained their original status; in conflict with the decision of the Eighth Circuit in that matter, in *Luehrmann v. Drainage Dist. No. 7.*

2. Holding that the prior executed partial (75%) refunding was not complete and that the changed debt status of the City, which resulted therefrom, could be ignored; in conflict with the applicable decisions of the Florida Supreme Court in the cases of *State ex rel. Garland v. City of West Palm Beach*, decided January 5, 1940, and *State v. City of West Palm Beach*, decided February 16, 1940.

3. Construing this Act of Congress to be applicable to a proceeding which is beyond the scope of compositions in bankruptcy.

4. Failing to test the application of the Act, beyond its composition scope, against Appellants' claims that the Fifth and Tenth Amendments were violated by going outside the limits of the Act; the Court having dealt with the question on the irrelevant theory of "vested rights."

ARGUMENT

Point I.

The Decision of the Circuit Court of Appeals Approving Majority Consents of Creditors Having Irrevocably Scaled their Debts Conflicts with the Decision of the Eighth Circuit in this Matter, in Luehrmann v. Drainage Dist. No. 7.

In the Luehrmann case, decided June 13, 1939 *(Luehrmann v. Drainage Dist. No. 7 of Poinsett County, Ark.*, 8 Cir., 104 F. (2d) 696, at 700-701), the Circuit Court of Appeals for the 8th Circuit considered an objection that the controlling consents were by those who had already scaled their debts to the terms involved. The refunding was one in which the creditors were to surrender their securities for money to be paid through funds advanced by the RFC. The plan was largely executed.

It was found and held that the participation of the majority had not resulted in a final scaling of the debts involved, because the steps taken were tentative, and conditioned upon ultimate 100% completion. The original rights had been preserved for possible resumption, if the plan should fail of complete consummation. The agreements were found to have been expressly so conditioned. The securities which had been surrendered were not cancelled—a point emphasized in this connection in this and the other drainage and irrigation district cases cited. The old securities were in the hands of a trustee, for the purpose mentioned.

Thus that Court said, "For this reason we think the classes of bondholders and judgment creditors so far retained their original status as entitled them to be counted as acceptors of this composition plan."

The question of the effect of partial execution had arisen in a number of such cases in District Courts in each of which the matter was resolved, as in the decision of the 8th Circuit, on the basis that the undertaking was expressly contingent upon total extension. *In re Drainage Dist. No. 7 of Poinsett*

County, Ark., 25 F. Supp. 372; *In re Merced Irr. Dist.*, 25 F. Supp. 981; *In re Lindsay-Strathmore Irr. Dist.*, 25 F. Supp. 988; and *In re Corcoran Irr. Dist.*, 27 F. Supp. 322.

The Corcoran case distinguished that situation from a non-contingent executed partial refunding, such as the bond-by-bond refunding in the Sanford case, and the 75% refunding in this Homestead case, and said, "We are not dealing here with a completed plan of reorganization. In re City of West Palm Beach, 5 Cir., 1938, 96 F. (2d) 85." The West Palm Beach case had revealed a bond-by-bond refunding contract substantially completed, but not contingent upon total completion. The Fifth Circuit had recognized it as such in 1938.

It is to be noted that the Luehrmann case and others cited, including the Corcoran case, were decided after the 1938 Amendment to the Act relating to the effect of partial execution of plans of composition.

The holding of the Fifth Circuit in the present case, approving majority consents of those who had scaled their debts and who had failed to preserve their original status, results and necessarily will result in conflicts on this point in the different Circuits.

In our case the Court appeared to recognize the necessity for preserving the original status, but evaded the feature by assuming that those who had settled might as well be considered as having revoked their settlement contracts. That assumption was unwarranted, because (a) such was not the fact; (b) the contract itself had required the old bonds to be cancelled when exchanged, and such had been done, extinguishing the old debt; and (c) restoration of the status *quo ante* was not legally possible, since the Florida Refunding Act would prevent withdrawal of the present refunding securities and their replacement now with securities in the original larger amounts.[1]

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(1) Chapter 15772, Laws of Florida, Acts of 1931, Section 14: "* * * The Principal and accrued interest of the refunding bonds shall not exceed the amount of the obligations refunded."

Point II.

The View of the Circuit Court of Appeals that the Executed Majority Refunding was not Complete so as to Accomplish a Changed Debt Status to that Extent, Conflicts with Decisions of the Florida Supreme Court.

The Florida Supreme Court has passed on the question in two cases, in which it considered the result and effect of a partial (majority) refunding by the City of West Palm Beach. The refunding plan proposed by that City in 1936 became executed as to holders of 93% of the bonds. Those who refunded had not preserved their original debt status. Their action was final and not contingent upon ultimate extension of the terms to all creditors of the classes affected. It appeared as a bond-by-bond refunding similar to the procedure employed by the City of Sanford. The only difference between it and the City of Homestead refunding was that the latter was contingent until 75% had contracted, but became final as to those creditors at that point and was then on the same bond-by-bond basis.

In *State ex rel. Garland v. City of West Palm Beach*, 193 So. 297, the Florida Court held that the proceeds of taxes levied under the Florida General Refunding Act of 1931, for servicing the new bonds which had been issued and exchanged in the partial refunding, were from a separate tax source, and beyond the reach of holders of defaulted unrefunded bonds. That holding was made in spite of the law of that State that a bondholder could impound and cause to be applied in payment of a defaulted security, any proceeds of taxes levied for payment of the original bond debt (Florida recognizes the "first come, first served" doctrine).

Thus, the partial refunding in the Homestead case has put that City in a position of levying taxes for interest and sinking fund for the new bonds exclusively, earmarked, and beyond the reach of holders of unrefunded bonds—a situation which could not prevail if the new debt created by delivery of refunding bonds was not final and unconditional.

Also, in *State v. City of West Palm Beach*, 193 So. 839, decided in February of 1940, the Florida Court validated bonds of that City issued for the purpose of refunding only the minority group which had refused its earlier majority refunding accomplished in 1936. That second partial refunding, applying only to the minority, was on more liberal terms.

Those who had participated in the majority refunding opposed validation, contending that all had to be treated on the same terms on which they had settled. The Florida Court held otherwise.

In so holding, the Florida Supreme Court upheld the action by which the City had abandoned its effort to force the original terms on the minority (after the 1938 Amendment of the Bankruptcy Act) "apparently conceiving difficulties that might be encountered in seeking relief in the bankruptcy court."

In the present case, the Circuit Court of Appeals proceeds on the theory that the executed majority refunding can be ignored, and that the prior total indebtedness should be considered as still existing in its original amount and status.

Point III.

The Circuit Court of Appeals Construed the Bankruptcy Act to be Applicable to a Proceeding which is Beyond the Scope of Bankruptcy Compositions.

The Circuit Court of Appeals of the Fifth Circuit had previously committed itself to the view that a composition in bankruptcy required that a controlling majority must have an identity of interest which does not exist in them after prior independent settlement. *In re The City of West Palm Beach, Fla.*, 5 Cir., 96 F. (2d) 85, *Texas Hotel Securities Co. v. Waco Development Co.*, 5 Cir., 87 F. (2d) 395, and *Continental Ins. Co. v. Louisiana Oil Ref. Corp.*, 5 Cir., 89 F. (2d) 333.

That Court had recognized that a majority who had refunded in the West Palm Beach matter could not be classed as acceptors in a purported bankruptcy composition designed to force the refunding terms upon the minority.

The decision in the West Palm Beach case occurred after the 1937 Municipal Bankruptcy Act was in effect, but before the addition of sub-section (j) by the Act of June 22, 1938, to Section 83 of the 1937 Act. (U. S. C. A., Title 11, § 403).

When this Homestead case came before the Court, the situation presented was the same in all material respects. The question, then, was whether the Act, with the benefit of the 1938 addition, authorized a creditor majority to exercise control in a manner beyond the scope of compositions in bankruptcy, and in violation of basic principles of compositions.

We feel that this is not the place for a detailed discussion of the features of the Act as amended, which compel the construction that the Act relates only to compositions in bankruptcy, and that the additional provision for voting by those who have participated in partial execution, refers to participation under a composition agreement, contingent upon its final extension to all, and is not intended to authorize those who have irrevocably scaled their debts to ignore their changed status.

We content ourselves at this time with saying that the definition in Section 82 of the Act (11 U. S. C. A. § 402), to the effect that "securities affected by the plan" are those as to which the holders' rights are to be materially changed or modified by the extension of the plan to all, remains controlling; and that the other material provisions of the Act, including the language of the amendment itself, show that great care was taken to confine the Act to bankruptcy compositions.

By sanctioning the consents of the refunded majority, the Circuit Court of Appeals has done one of two things: (a) it has construed the amendment to destroy the composition character and limit of the Act, or (b) it has approved

an application of a composition statute to a situation of a character previously recognized by that Court as not constituting a composition. From the Court's opinion, it is not clear which was the basis of its decision, although in the Homestead opinion the Court intimated that because the refunding was begun at a time when a valid composition Act was in existence, the refunding might be presumed to have had the characted of a composition—an inference refuted by the nature of the refunding contract itself and the action taken under it.

Point IV.

In Upholding an Application of the Act Beyond its Composition Scope, the Decision of the Circuit Court of Appeals Ignores Constitutional Barriers.

In its consideration of the 1937 Act, in the case of *United States v. Bekins*, 304 U. S. 27, this Honorable Court pointed out that the Act invoked the bankruptcy power in relation to a matter normally within its province, and was restricted to bankruptcy compositions. As such, the Act was approved, as not conflicting with the Fifth Amendment. State consent avoids conflict with the Tenth Amendment, but that consent is no broader than the Act.

If the Amendment of 1938, relating to the effect of partial execution of composition agreements, has lifted the Act into a field of bankruptcy not normally within its province, or otherwise beyond the scope of bankruptcy compositions, then its validity, in the case presented, should have been tested against the Fifth and Tenth Amendments. That test should be on the basis of whether it results in depriving the minority of rights and property without due process of law, and on whether the State's consent is adequate under the enlarged scope.

If the Act as amended remains restricted to composition agreements, the present application beyond its scope gives it an operation outside of the restrictions on its use which

this Court pointed out in the Bekins case. Approval of such practice by the Circuit Court of Appeals is a misinterpretation of this Court's opinion in the Bekins case, and represents a failure of the Circuit Court of Appeals to follow and apply the ruling of this Court.

Respectfully submitted,

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